In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 949

ESTATE OF MAX STEINBERG, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED SATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The Commissioner determined income tax deficiencies against Max Steinberg (now deceased) individually for 1947, 1948 and 1949 (for which years he had filed separate rather than joint returns), and against both Steinberg and his wife Pearl jointly for 1950 and 1951 (for which years they had filed joint returns) (R. 19-20).[1] Such deficiencies were based

[1] "R." refers to the appendix to petitioners' brief in the court of appeals.

on the net worth method, and the Commissioner determined that the taxpayers had unreported net income totaling $130,440.89 for 1947 through 1949, and $72,360.52 for 1951 and 1952 (R. 24-25).[2] The Tax Court held (R. 29) that there was convincing evidence that during the years involved the taxpayers, "as a husband and wife team, were in possession of funds and received income of unidentified origin greatly in excess of gross income reported, and of any previously accumulated funds properly accounted for." The court ruled (R. 31-32), however, that the Commissioner had failed to establish his case against Max for the years 1947 through 1949. It stated (*ibid.*) that although the deficiencies were asserted solely against Max individually, the increases in net worth were attributed "almost entirely to funds or property standing in the name of or belonging to Pearl"; and that the evidence did not show "which increases, if any, were his alone during the years 1947 through 1949" and did not link Max "as a likely source of income, to Pearl's increase in net worth."

The Tax Court upheld the deficiencies against both Max and Pearl for 1950 and 1951 (when joint returns had been filed), since the evidence showed "substantial increases over and above [taxpayers'] reported income plus all other nontaxable income or

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[2] The assessment of such deficiencies was barred by the statute of limitations unless the taxpayers had committed fraud. The Tax Court held that there was "cogent evidence of fraud" (R. 33), and the court of appeals upheld the finding of fraud (Pet. App. 2). That finding is not challenged here.

accretions to net worth from proven sources" (R. 29-30) and "[t]he increase in net worth for those years would, of course, include any income derived by or property belonging to either spouse" (R. 33).

In affirming the Tax Court, the court of appeals stated that "[b]y using the 'increase in net worth' method, the Commissioner showed that petitioners received income which they did not report in 1950 and 1951"; that the "net worth figures were the result of an extensive investigation by government agents into the financial affairs of both Pearl and Max"; and that although the investigation "did not reveal the source of the income," it did show that Pearl's claims that prior to 1946 she had accumulated a substantial cash hoard from "many non-taxable sources" were "untrue" (Pet. App. 2).

The court of appeals correctly upheld the deficiencies for 1950 and 1951, and there is no occasion for further review.

Petitioners contend (Pet. 2, 4) that in his answer in the Tax Court, the Commissioner stated that his case rested upon the claim that Max had additional income for 1950 and 1951 and disclaimed any reliance upon additional income of Pearl; and that the Tax Court's reliance upon evidence of Pearl's additional income for those years violated Rule 14 of its Rules of Practice, which requires the answer to "advise the petitioner and the Court fully of the nature of the defense" (Pet. 3). The portions of the answer upon which they rely (Pet. App. 4), however, stated that in those years "petitioners" (emphasis added) received unreported income from Max's "busi-

ness, investments, and/or other sources." The court of appeals reasonably interpreted these statements as putting the taxpayers on notice that the Commissioner was not restricting his case to proof of "unreported income generated by Max alone" (Pet. App. 4).

Petitioners have not shown that they suffered any prejudice from the alleged deficiencies in the answer; they point to no evidence they refrained from offering because of belief that the Commissioner was limiting his case to proof of Max's unreported income. Indeed, the Commissioner may even change his theory of tax liability on appeal, provided that the taxpayer suffers no disadvantage therefrom. *Commissioner* v. *Hopkinson*, 126 F. 2d 406, 409 (C.A. 2); cf. *Hormel* v. *Helvering*, 312 U.S. 552, 560 (further proceedings ordered to allow taxpayer opportunity to produce evidence relevant to new theory of liability adopted on appeal). Furthermore, the Tax Court did not find, as petitioners contend (Pet. 4-6), that Pearl was the source of the additional income; it found that Pearl and Max received the additional income "as a husband and wife team" (R. 29).

Petitioners further contend (Pet. App. 4) that the Commissioner in his brief before the Tax Court similarly disclaimed reliance on proof that Pearl had any unreported income. In the excerpt of the brief which they quote (Pet. App. 5), however, the Commissioner stated only that the evidence did not disclose any source of her additional unreported income. In a net worth case the government need not establish a likely source of the unreported income where its investiga-

tion negatives the non-taxable sources that the taxpayer has suggested. *United States* v. *Massei*, 355 U.S. 595; *Holland* v. *United States*, 348 U.S. 121, 137-138. The Tax Court properly took account of this rule in holding that the Commissioner had proven fraudulent understatement of income for 1950 and 1951 (R. 33-34).

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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